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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into the Review of the California High Cost Fund B Program.	**FILED** **PUBLIC UTILITIES COMMISSION** **JUNE 29, 2006** **SAN FRANCISCO, CALIFORNIA** **RULEMAKING 06-06-028**

ORDER INSTITUTING RULEMAKING REGARDING CALIFORNIA HIGH COST FUND-B PROGRAM

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ORDER INSTITUTING RULEMAKING REGARDING CALIFORNIA HIGH COST FUND-B PROGRAM

I. Introduction

Pursuant to SB 1276 (Chapter 847, Statutes of 2004)[1] the Commission by this Order Instituting a Rulemaking (OIR) is commencing a review of the state's California High Cost Fund B (B-Fund) program. The goals of this review include, but are not limited to, adjusting universal service rate support payments to reflect updated operating costs, evaluating whether B-Fund support levels can be reduced and made more predictable while still meeting the goals of the program, ensuring it is competitively neutral, reducing rate disparity in residential basic service between urban and rural areas in the state, and finally, making the current administration of the program more efficient.

Any review of the B-Fund program must begin with the original purposes and goals of the program, as articulated by the Legislature in statutes and in our decisions adopting the program. We seek comment on whether the program is meeting its respective statutory purposes and requirements. To the extent deficiencies are identified, constructive remedial proposals should be provided.

When the program was created, landline telephone service provided by monopoly service providers was the only widely-available form of affordable

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[1] SB 1276 (Chapter 847, Statutes of 2004) states:

> SEC. 4. The Public Utilities Commission shall by January 1, 2006, conduct a review of the program established pursuant to subdivision (c) of Section 739.3 of the Public Utilities Code and of the California High-Cost Fund-B Administrative Committee Fund, to accomplish both of the following:
> (a) Adjust universal service rate support payments to reflect updated operating costs, (b) Evaluate whether universal service rate support levels can be reduced while still meeting the goals of this program.

telecommunications service. Since then, new technologies, such as wireless telephones and Internet-based communications (such as Voice over Internet Protocol) have greatly expanded the range of telecommunications services that are available and affordable. In this context, the statutory goals and specifications of the B-Fund program may require modernization. The first inquiry is whether the program remains necessary to achieve the fundamental statutory goal of enhancing universal service and, if so, whether changes are necessary to further this goal in today's competitive and technologically varied telecommunications environment.

At the core of our review of these programs is our duty to be accountable to the people of California. This program is funded by surcharges on the telephone bills of Californians. We have an obligation to ensure that the funds obtained from the surcharges are being wisely spent to provide the most advanced telecommunications services to all Californians.[2]

II. Federal and State Legislative History

Universal service ensures that consumers have access to basic telephone service in their homes that is both affordable and ubiquitously available. Legislatures have codified this policy, finding that as more citizens are connected to the network, the value of the network grows. Thus, it has been a longstanding commitment of federal and state governments to promote universal service.[3]

A review of the B-Fund must begin with the original purposes and goals of the program, as articulated in statutes and in our decisions adopting the

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[2] PU Code Section 709.

[3] See PU Code Section 709; 47 U.S.C. §§ 151, 254.

program. We review the federal and state legislative directives to help provide background for comment on whether the programs are meeting their respective statutory purposes and requirements.

A. Federal History

The United States Congress, as early as 1934, made universal service a basic goal of telecommunications regulation with the passage of the Communications Act of 1934 ("1934 Act"). Section 1 of the 1934 Act indicates that the Federal Communications Commission (FCC) was created:

> [f]or the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . . .[4]

In 1996, Congress passed the Telecommunications Act of 1996 ("1996 Act"). This was the first major overhaul of United States telecommunications policy in nearly 62 years and it modified earlier telecommunications legislation, primarily the 1934 Act. The 1996 Act codified (in section 254 of the 1996 Act) the FCC's longstanding practice of providing universal service support for "telecommunications services" in high cost and low income areas. Section 254 of the 1996 Act also defines the nature of "universal service" as "an evolving level of telecommunications services" that takes into account telecommunications service advancements. The FCC and a working group of State Public Utility Commission officials (Federal-State Joint Board on

[4] 47 U.S.C. § 151 (as amended).

Universal Service) were charged with establishing specific, predictable, and sufficient support mechanisms to preserve and advance universal service.[5] In addition, in section 254(b), Congress provided a list of principles upon which the FCC must base policies for the preservation and advancement of universal service.[6] Additionally, section 254(b) provides that consumers in rural, insular, and high cost areas should have access to telecommunications services at rates that are "reasonably comparable to rates charged for similar services in urban areas."[7] Furthermore, section 254(e) provides that the federal universal service support "should be explicit and sufficient to achieve the purposes of this section."[8] Finally, the 1996 Act also includes a provision that directs the FCC to create discounted telecommunications and certain advanced services for schools, libraries, and rural health care providers.[9]

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[5] 47 U.S.C. § 254.

[6] 47 U.S.C. § 254(b)(1)-(7). The principles are (1) Quality services should be available at just, reasonable, and affordable rates; (2) Access to advanced telecommunications and information services should be provided in all regions of the nation; (3) Consumers in all regions of the should have access to telecommunications and information services, including advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and reasonably comparable to rates charged for similar services in urban areas; (4) All providers of telecommunications services should contribute in an equitable and nondiscriminatory manner; (5) Federal and State support mechanisms must be specific, predictable and sufficient to preserve and advance universal service; (6) Schools, libraries, and rural health care providers should have discounted access to advanced telecommunication services; and (7) Any other principles as the Joint Board and the FCC determine are necessary and appropriate – which the FCC used to add a competitive neutrality requirement.

[7] 47 U.S.C. § 254(b)(3).

[8] 47 U.S.C. § 254(e).

[9] 47 U.S.C. § 254(h).

With respect to the state's authority to regulate universal service, the 1996 Act maintained the longstanding federal-state compact, stating:

> (b) State Regulatory Authority.—Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with Section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.[10]

B. California Legislative History

In 1987, the California legislature enacted Public Utilities (PU) Code Section 739.3 requiring the Commission to develop, implement, and maintain a suitable program to establish a fair and equitable local rate structure aided by transfer payments to small independent companies serving rural and small metropolitan areas.[11] For these smaller companies, the Commission had already established the California High Cost Fund–A in 1985 for the purpose of allowing these small companies to receive universal service support.[12]

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[10] 47 U.S.C. § 253 (b).

[11] PU Code Section 739.3(a), (b).

[12] D.85-06-115 as modified by D.88-07-022, D.88-12-044 and D.91-09-042. The California High Cost Fund (i.e. the current CHCF-A) was implemented by D.88-07-022 as modified by D.91-05-016 and D.91-09-042 to provide a source of supplemental revenues to three mid-size and seventeen small LECs whose basic exchange access line service rates would otherwise be increased to levels that would threaten universal service. D.96-10-066 changed the name of the High Cost Fund to CHCF-A and created the California High Cost Fund-B (B-Fund). This decision included the three mid-size LECs in the B-Fund program for the purpose of determining universal service subsidy support and maintained the CHCF-A for the 17 small LECs. CHCF-A is funded by a surcharge assessed on consumers' intrastate telecommunications services.

In 1994, the Commission began developing a procedural plan to facilitate opening local exchange telephone markets to competition by January 1, 1997. While the Commission was developing its plan for local competition, the Legislature acknowledged increasing competition in telecommunications markets and required the Commission to examine the current and future definitions of universal service, including how universal service should work in the new and expected increasingly competitive markets[13] consistent with PU Code § 709.[14] Then, in September 1996, the Legislature amended PU Code Section 739.3 to:

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[13] AB 3643 (Stats. 1994, Ch. 278).

[14] *Ibid.* PU Code § 709 states as follows:

> The Legislature hereby finds and declares that the policies for telecommunications in California are as follows: (a) To continue our universal service commitment by assuring the continued affordability and widespread availability of high-quality telecommunications services to all Californians. (b) To focus efforts on providing educational institutions, health care institutions, community-based organizations, and governmental institutions with access to advanced telecommunications services in recognition of their economic and societal impact. (c) To encourage the development and deployment of new technologies and the equitable provision of services in a way that efficiently meets consumer need and encourages the ubiquitous availability of a wide choice of state-of-the-art services. (d) To assist in bridging the "digital divide" by encouraging expanded access to state-of-the-art technologies for rural, inner-city, low-income, and disabled Californians. (e) To promote economic growth, job creation, and the substantial social benefits that will result from the rapid implementation of advanced information and communications technologies by adequate long-term investment in the necessary infrastructure. (f) To promote lower prices, broader consumer choice, and avoidance of anticompetitive conduct. (g) To remove the barriers to open and competitive markets and promote fair product and price competition in a way that encourages greater efficiency, lower prices, and more consumer choice. (h) To encourage fair treatment of consumers through provision of sufficient information for making informed

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> [D]evelop, implement, and maintain suitable, competitively neutral, and broad-based program to establish a fair and equitable local rate support structure aided by universal service rate support to telephone corporations serving areas where the cost of providing service exceeds rates charged by providers, as determined by the Commission.[15]

In other words, the purpose of the program was to promote the goals of universal telephone service and to reduce any disparity in the rates charged rural and urban customers.

In 1999, the Legislature created the California High Cost Fund-B (CHCF) Administrative Committee Fund within the State Treasury.[16] This legislation further provided that the funding would be in rates, while the funds collection would be submitted first to the Commission, and then deposited with the Controller for deposit in the California High Cost Fund-B Administrative Committee Fund.[17] This same legislation also required periodic audits of the B-Fund, on at least a three-year basis.

In 2001, the Legislature allowed funds to be transferred between various telephone funds in the annual budget act.[18] The Legislature also demonstrated its concern with stale data underlying the B-Fund. Section 270(b) restricted the transfer of funds until the service costs from the Commission's 1996 decision

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choices, establishment of reasonable service quality standards, and establishment of processes for equitable resolution of billing and service problems.

15 PU Code Section 739.3(c), pursuant to SB 207 (Stats. 1996, Ch. 750).

16 Government Code Section 270(a)(2), pursuant to SB 669.

17 Government Code Section 276(b).

were recalculated.[19] Subsequently, the Budget Act of 2002 transferred nearly $251 million of High Cost Fund-B money to the state general fund.[20]

In 2004, PU Code 739.3 was further amended to: (a) provide that money in Commission-regulated telecommunications related funds are the proceeds of rates, and therefore, are held in trust for the benefit of ratepayers and to compensate telephone corporations for their costs of providing universal service; (b) extend funding for the various universal service programs including the B-Fund program until January 1, 2009;[21] and (c) further require the Commission to conduct by January 1, 2006, a review of the B-Fund.[22] The purpose of the review was "to accomplish an adjustment of subsidy payments to reflect updated operating costs and an evaluation of whether subsidy levels can be reduced while maintaining the goals of the program."[23]

C. Current Statutory Provisions Governing the B Fund

The statutory provisions governing the B-Fund now read as follows:

> § 739.3 (c) The commission shall develop, implement, and maintain a suitable, competitively neutral, and broad based

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[18] PU Code Section 276, pursuant to Section 20 of SB 742 (2001), as amended by Stats. 2001, Ch. 903 §5.

[19] PU Code Section 270(b)(2), pursuant to AB 140 (Statutes of 2001). The Legislature restricted fund transfers from the B-Fund to the other high cost fund until statewide data was recalculated.

[20] AB 425 Provision 8660-011-047.0 (Stats. 2002, Ch. 379).

[21] PU Code Section 739.3, pursuant to SB 1276 (Stats. 2004, Ch. 847, enrolled September 28, 2004).

[22] SB 1276 §4 (Stats. 2004, Ch. 847).

[23] *Ibid.*

> program to establish a fair and equitable local rate support structure aided by universal service rate support to telephone corporations serving areas where the cost of providing services exceeds rates charged by providers, as determined by the commission. The commission shall develop and implement the program on or before October 1, 1996. The purpose of the program shall be to promote the goals of universal telephone service and to reduce any disparity in the rates charged by those companies. Except as otherwise explicitly provided, this subdivision does not limit the manner in which the commission collects and disburses funds, and does not limit the manner in which it may include or exclude the revenue of contributing entities in structuring the program.
>
> (d) The commission shall structure the programs required by this section so that any charge imposed to promote the goals of universal service reasonably equals the value of the benefits of universal service to contributing entities and their subscribers.
>
> (e) The commission shall investigate reducing the level of universal service rate support, or elimination of universal service rate support in service areas with demonstrated competition.
>
> (f) This section shall remain in effect until January 1, 2009, and as of that date is repealed, unless a later enacted statute that becomes effective on or before January 1, 2009, deletes or extends that date.[24]

We seek comment, as prescribed in further detail below, on whether the programs are meeting their respective statutory purposes and requirements. To the extent deficiencies are identified, constructive remedial proposals should be provided, with supporting rationale.

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[24] *Ibid.*

D. Regulatory Background Impacting the B-Fund

In December 1994, the Commission adopted its "Road Map Decision," which laid out a multi-proceeding plan facilitating local competition.[25] The plan identified completing its Open Access and Network Architecture Development (OANAD) proceeding,[26] and considering intraLATA presubscription during the next review of Pacific Bell's and Verizon's "New Regulatory Framework" (NRF) Reviews as necessary parts of the road map. The Commission also ordered new proceedings to establish rules for local exchange competition,[27] and to examine universal service issues as required by the Legislature.[28]

The universal service proceeding began in January 1995 to develop rules to further the goals of universal service in a competitive telecommunications environment.[29] The Legislature provided guidance as to the types of issues the Commission should address in its rulemaking and investigation proceeding:

(1) Define the goals of universal service given the new technologies and increasingly competitive markets, with emphasis on the role of basic service in education, health care, and the workplace.

(2) Delineate the subsidy support needed to maintain universal service in the new competitive market.

(3) Design and recommend equitable and broad based subsidy support for universal service in freely competitive markets.

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[25] D.94-12-053.

[26] R.93-04-003/I.93-04-002.

[27] R.95-04-043/I.95-04-044.

[28] AB 3643 (Statutes 1994 Chapter 278). R.95-01-020/I.95-01-021.

[29] *Ibid*. at 1-2.

(4) Develop a process to periodically review and revise the definition of universal service to reflect new technology and markets.

(5) Address the issues of 'carrier of last resort' and 'franchise obligations.'[30]

As a result, in July 1995 the Commission set forth proposed rules for further comments pertaining to universal service responsibilities in a competitive environment.[31] In December 1995, the Commission allowed for evidentiary hearings and workshops to facilitate the development of the Cost Proxy Model (Model) to be used to measure costs of providing basic telephone service within California.[32]

In October 1996, the Commission established the B-Fund program for the largest NRF ILECs[33] to promote the goal of universal telephone service while attracting competition to high cost areas.[34] Additionally, the program was to provide explicit universal service fund subsidies to Carriers of Last Resort providing basic residential telephone service in high cost areas of California's four largest Incumbent Local Exchange Carriers (ILECs) under NRF.[35]

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30 AB 3643 (Statutes 1994 Chapter 278) at §2(a).

31 D.95-07-050.

32 D.95-12-021.

33 D.96-10-066.

34 Ibid. at p. 168.

35 Pacific Telephone Company (SBC/AT&T), GTE and Contel of California (Verizon California), Roseville Telephone Company (Surewest), and Citizens Telephone Company of California (Frontier Communications) service territories were used for purpose of determining universal service support in their service areas (D.96-10-066, p. 102).

Subsequent to this Decision, Carrier of Last Resort status was also granted to three competitive local exchange carriers (CLECs).[36] Recently, two of the CLECs merged with the ILECs leaving just one non-ILEC Carrier of Last Resort.[37] A Carrier of Last Resort must serve all residential and business customers who request service in its service territory.[38] To keep the size of the fund at a reasonable level, the Commission limited the availability of B-Fund to only one residential line (Primary Line) per household.[39]

The goals of the B-Fund program are to promote the universal telephone service and reduce rate disparity in residential basic service telephone rates between urban and rural areas, while encouraging competition. To maintain competitive neutrality, the Commission ordered reductions in certain ILEC rates (excluding rates for residential basic service) by the amount of B-Fund subsidy received by the Carriers of Last Resort instead of through rates. Through this action, the B-Fund subsidies would replace the implicit subsidies that were built into rates for services priced above cost to help offset the cost of providing universal service. By making what had been implicit subsidies explicit, the program was intended to provide a competitively neutral funding mechanism that applied to all service providers in the NRF ILECs' service territories. This

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[36] Cox was granted COLR status in 1999, MCI in 2003 and AT&T in 2004.

[37] AT&T was merged into SBC and MCI Metro was merged into Verizon California in January 2006.

[38] D.96-10-066, p. 301.

[39] *Ibid*. at p. 195.

mechanism was expected to remove previous barriers to local competition and to reduce rate disparity within each company's service territory.[40]

The B-Fund program is funded by an all-end-user surcharge[41] that is billed and collected by telecommunications carriers from their customers.[42] Designated Carriers of Last Resort submit claims for one primary line served in each household.[43] The Carriers of Last Resort are paid by the State Controller after their legitimately submitted claims have been reviewed by the Telecommunications Division (TD).[44]

III. Developments That May Impact the B-Fund

There are a number of current developments that could have a significant impact on the B-Fund program. These include: developments at the FCC,

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40 *Ibid*. at pp. 317-318.

41 *Ibid*. at p. 185.

42 Customers who are exempt from paying into the B-Fund are: Universal Lifeline Telephone Service (ULTS), coin sent paid calls, debit cards messages, one-way radio paging, customer-owned pay telephone (COPT) usage charges, directory advertising and pre-existing customer contracts executed on or before September 15, 1994. D.96-10-066, p. 191.

43 Offsets to estimated CBG costs include revenue from the incumbent carrier's flat rate service, the end user common line charge (EUCL), and revenues per subsidized line from the carrier common line charge (CCLC) and the federal universal service fund (USF). D.96-10-066, Appendix B, Rule 6.C.2.

44 D.98-09-039, Ordering Paragraph 7 states: "The CHCF-B Administrative Committee shall review each monthly claim submitted by the large LECs. Upon completion of each monthly claim, the Committee shall provide written notice to the large LEC submitting the claim regarding the amount of the claim that the LEC is authorized to draw from its accumulated CHCF-B surcharge revenues."

developments in other States, and outcome of other Commission pending proceedings.

A. Developments at the FCC

There are two developments that could have a significant impact on the B-Fund. These are potential reforms to the Federal Universal Service[45] and Inter-carrier Compensation programs.[46] The reforms and revisions adopted by the FCC may have an impact on how we determine the funding levels of the B-Fund program in coming years as well as impact the collection of funds. Therefore, we will require the Telecommunications Division to monitor these developments and suggest further modifications for our consideration.

1. Reforms to Federal Universal Service

In February of 2005, the United States Court of Appeals for the Tenth Circuit decision in Qwest Corp v. FCC (Qwest II) remanded the FCC's latest attempt to justify the creation of a federal high-cost mechanism for non-rural carriers[47] and ordered the FCC to develop a new method by which it may

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[45] Federal-State Board on Universal Service, CC Docket No. 96-45, and, High-Cost Universal Service Support, WC Docket No. 05-337 Notice of Proposed Rulemaking. (Qwest II Remand NPRM) Adopted: 9 Dec 2005. Available: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-205A1.pdf [27 Feb 2006].

[46] Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, *Notice of Proposed Rulemaking*, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*). Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92 *Further Notice of Proposed Rulemaking* (*Intercarrier Compensation Further NPRM*) Adopted: 10 Feb. 2005. Available: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-33A1.pdf [27 Feb 2006].

[47] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*), *remanded*, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2003) (*Qwest I*), *Order on Remand*, 18 FCC Rcd 22559 (2003), *remanded*, *Qwest II*, 398 F.3d 1222.

determine support for non-rural carriers, or find a way to defend the current forward-looking approach. Qwest II directed the FCC to re-define a definition of "sufficient" and "reasonably comparable" in respect to their application in section 254 of the Communications Act of 1934, as amended.[48] Because the non-rural, high-cost support mechanism rests on the application of the definition of "reasonably comparable" rates that was invalidated by the court, the court also deemed the support mechanism invalid.[49] The court also noted that the Commission based the two standard deviations cost benchmark on a finding that rates were reasonably comparable, without empirically demonstrating a relationship between the costs and the rates in the record.[50] The FCC issued a Notice of Proposed Rulemaking in CC Docket No. 96-45 and WC Docket No. 05-337 on December 9, 2005.[51] The Notice of Proposed Rulemaking sought comments on the remand decision.[52] This FCC rulemaking will address several issues:

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[48] Qwest Corp. v. FCC, 398 F.3d 1222 (10th Cir. 2005).

[49] *Id.* at 1237.

[50] *Id.*

[51] Qwest II Remand NPRM.

[52] *Qwest II Remand NPRM* at p. 13-15. Specifically it seeks input on:

The implications, structure, and design of a rate-based approach;

The viability of the current cost-based approach given the "rate-related goals" of the 1996 Act;

Other proposals, outside of rate-based or cost-based mechanisms, that address the 1996 Act's goals, and;

The National Association of Regulatory Utility Commissioners' proposal that the FCC set guidelines for the use of high-cost funds, but within that framework, allow each state to distribute their allocation of the high-cost funds. *See* National Association of

Footnote continued on next page

(1) How to reasonably define the statutory term "sufficient," consistent with all the principles enumerated in section 254(b) of the Telecommunications Act of 1996, including affordability;

(2) How to reasonably define the statutory term "reasonably comparable;"

(3) How to modify the high-cost funding mechanism for non-rural carriers in response to the Qwest II court decision; and

(4) Whether the Commission should adopt an interim non-rural insular mechanism proposed by Puerto Rico Telephone Company.[53]

Comments in the FCC Docket were filed on March 27, 2006 and reply comments were filed on May 26, 2006.

California currently utilizes a cost-based model for the B-Fund. We request comment on how these potential approaches and structures might impact California's programs in light of the Qwest II court's decision and the FCC's current deliberations.

2. Inter-Carrier Compensation

Interconnection arrangements between carriers are currently governed by a complex system of inter-carrier compensation mechanisms that distinguish between different types of carriers and different types of services based on

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Regulatory Utility Commissioners. *Intercarrier Compensation Proposal Version 7.* ONLINE. 2005. Available: http://www.neca.org/media/NARUCICfiling5_19_05.pdf [28 Mar 2006] p. 12.

[53] National Regulatory Research Institute. Abstract, FCC 05-205, Notice of Proposed Rulemaking in the Matter of Federal-State Joint Board on Universal Service and

Footnote continued on next page

regulatory classifications. Federal and state access charge rules govern the payments that providers (such as inter-exchange carriers, commercial mobile radio service, or other local exchange carriers) make to LECs that originate and terminate long-distance calls.[54] Such access charges are intended to compensate LECs for use of the local plant to begin or complete a long-distance call. Reciprocal compensation established under Section 251(b)(5) of the 1996 Act generally governs the compensation between telecommunications carriers for the transport and termination of calls not subject to access charges.[55] These rules apply different cost methodologies to similar services based on traditional regulatory distinctions that historically had little or no bearing on the cost of providing service and many of which may be increasingly difficult to sustain in the current evolving telecommunications marketplace.

The FCC is seeking comments on inter-carrier compensation with an aim of replacing the myriad of existing inter-carrier compensation regimes with a unified regime designed for a market characterized by increasing competition and new technologies.[56] The FCC acknowledged that a number of problems exist with the current inter-carrier compensation regimes (access charges and

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High-Cost Universal Service Support, ONLINE. 2005. Available: http://www.nrri.ohio-state.edu/dspace/handle/2068/884 [06 Mar 2006].

54 *See generally*, PU Code Sections 489, 490, 495.7, 709, and 728.7.

55 47 U.S.C. § 251(b)(5). Intrastate access charges, and intrastate calling generally, are governed by state public utility commissions. Thus, different inter-carrier compensation regimes apply to a call originating in Sacramento depending on, for example, whether it terminates in Sacramento, elsewhere in the state of California, or in another state. Different rules also apply depending on whether the calling and the called parties are using wireline or wireless services.

56 Intercarrier Compensation Further NPRM.

reciprocal compensation) and expressed interest in identifying a unified approach to inter-carrier compensation.[57] The FCC solicited comments on a bill-and-keep approach to reciprocal compensation payments governed by section 251(b)(5) of the 1996 Act. The FCC also sought comments on alternative reform measures that would build upon current requirements for cost-based inter-carrier payments.[58]

In response to the FCC's NPRM, a number of parties developed proposals for comprehensive reform of existing inter-carrier compensation regimes and submitted those proposals for FCC review. The FCC is seeking comments on each of these proposals including the economic and legal basis of the proposals, as well as the end-user effects and universal service issues implicated by the proposals.[59] We are monitoring this federal activity because what the FCC decides to do in its Intercarrier Compensation proceeding may impact the size of the federal universal service funds available to California, which in turn may have an impact on the California state universal service programs.

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[57] The existing inter-carrier compensation rules may be categorized as follows: access charge rules, which govern payments that IXCs and CMRS providers make to LECs to originate and terminate long-distance calls; and reciprocal compensation rules, which, generally speaking, govern the compensation between telecommunications carriers for the transport and termination of "local" traffic. However, both sets of rules are subject to various exceptions, such as enhanced service provider (ESP) exemption from the payment of access charges (allowing exemptions for internet service providers). *Intercarrier Compensation NPRM.*

[58] *Ibid.*

[59] Intercarrier Compensation Further NPRM.

B. Related Universal Service Activity in Other States

Currently, there are nineteen states (including California) that maintain a functioning high-cost fund.[60] Of these, fourteen states (including California) operate programs similar to the B-Fund (i.e., large ILECs are allowed to participate).[61] These states utilize a variety of models and methods to determine eligibility and carrier reimbursement. Appendix B contains program information for these other states.

One state that has a program similar to California, the State of Colorado, is undergoing a review of its High Cost fund program. Colorado is evaluating issues such as the need for and the size of its High Cost Support Mechanism (Colorado High Cost Fund), appropriate modeling that reflects high-cost areas, accountability for the use of funds, whether the Commission should target funding to certain areas, and the impact of advanced technologies over which state maintains no jurisdiction.[62] While California operates two separate high cost funds (the A- Fund and the B-Fund) and is the only state to do so, the Colorado High Cost Fund is similar to the B-Fund in that the large incumbent

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[60] AK, AR, AZ, CA, CO, ID, IL, KS, ME, NE, NV, OR, PA, SC, TX, UT, WA, WI, and WY. In addition, three states have approved, but not functioning, High Cost Fund (Fl, IN, VT). Ed Rosenberg and Jing Liu. *State Universal Funding Mechanisms: Results of the NRRI's 2005-2006 Survey*. Columbus, Ohio: National Regulatory Research Institute [Draft: April 2006]. Additional information was garnered through CPUC interviews with state regulatory commissions during February 2006.

[61] AK, AZ, CA, CO, ID, KS, ME, NE, NV, OR, SC, TX, WI, and WY.

[62] Colorado Public Utilities Commission. Docket No. 05I-431T, Proceeding in the Matter of the Investigation of the Colorado High Cost Support Mechanism, ONLINE. Effective: 14 Oct 2005. Available: http://www.dora.state.co.us/puc/docket_activity/HighprofileDockets/05I-431T.htm [28 Mar 2006].

provider, Qwest, receives nearly all of the funding (96% in 2005). In total, Qwest received $58,386,874 during the 2005 calendar year. This money supported 2.2 million access lines.[63]

In addition to the non-rural incumbent telecommunication provider, Qwest, and the rural incumbent telecommunications providers, one competitive local exchange carrier and one wireless provider are also eligible to receive support from the Colorado High Cost Fund. The wireless provider received $1,983,091 in 2005 (3% of the fund).[64] The Colorado High Cost Fund supports all eligible residential and business lines, not simply a single primary line.[65]

For the 2005 calendar year, Colorado utilized HAI 5.2 to determine the level of high-cost support provided to Qwest. HAI 5.2 is a forward-looking, cost-proxy model, which relies, in part, on data from Census Block Groups, to determine the cost of universal service. The Colorado Commission updated data in the HAI model utilizing the Automated Reporting Management Information System (ARMIS), a system used by the FCC to collect statistics from carriers regarding finances, service quality, and physical infrastructure.[66] Colorado has not, however, updated its model to reflect changed customer location data. Qwest receives support based on average revenues for an individual wire center,

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[63] Colorado Public Utilities Commission. Annual Report of the Colorado High Cost Support Mechanism. ONLINE. 2005. Available: http://www.dora.state.co.us/puc/telecom/hcsm/hcsm2005AnnualReport.pdf [28 Mar 2006]. pp. 11, 13.

[64] *Ibid*, 9 and 11.

[65] The B-Fund provides support for only one primary line per household.

[66] *Ibid*, 6. See also: Federal Communications Commission. *ARMIS Data Descriptions.* ONLINE. Available: http://www.fcc.gov/wcb/armis/descriptions.html [07 June 2006].

subtracted from the average cost determined by the forward-looking, least-cost model (HAI 5.2, with modifications). After subtracting certain revenues and investments, the amount left is compared with the average per line cost and the corporation is reimbursed for costs over that average.

In Colorado, Qwest received about $20 million in federal interstate access support in 2005.[67] This represents about a quarter of Qwest's total high cost support in Colorado. Because a Competitive Local Exchange Carrier is now eligible for support in some of Qwest's service territory, the amount of high cost funding is now based on "the actual supported residential and business access line counts multiplied by the applicable support per access line."[68]

Colorado High Cost Fund support is collected through an end-user surcharge of 2.9%. This level allows the fund to maintain a reserve of $9- $10 million annually, approximately 16% of the 2005 disbursements.[69]

We recount Colorado's experience to show how other states may provide some ideas for reform and revisions of our program. This proceeding is designed to address many of the same questions asked by Colorado. Therefore, we solicit comments concerning forward looking and innovative developments in other state jurisdictions that may offer useful insights as we revise our B-Fund

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[67] Universal Service Administrative Company. Fourth Quarter Appendices – 2005, High Cost Support Projected by State by Study Area, HC01. ONLINE. 2005. Available: http://www.universalservice.org/about/governance/fcc-filings/2005/quarter4/default.aspx [07 Jun 2006].

[68] Colorado Public Utilities Commission. *Annual Report of the Colorado High Cost Support Mechanism.* ONLINE. 2005. Available: http://www.dora.state.co.us/puc/telecom/hcsm/hcsm2005AnnualReport.pdf [28 Mar 2006]. at p. 12.

[69] *Ibid*, 3.

program. We also seek input on comparisons with California of the effectiveness, operation, and benefits of funds in other state jurisdiction.

C. Other CPUC Proceedings Affecting the B-Fund

Rulemaking 05-04-005 (the "Uniform Regulatory Framework" or "URF" proceeding) was opened to assess and revise telecommunications regulation in California with the primary goal of developing a uniform regulatory framework for all telecommunications utilities, except small incumbent local exchange carriers, to the extent that it is feasible and in the public interest to do so.[70]

The scope of R.05-04-005 identified elements of one possible framework that would, among other things, provide pricing flexibility for all services except basic local exchange service, over a transition period. However, the Rulemaking did not limit its consideration to a single proposal, and respondent parties suggested that B-Fund subsidies raise significant issues in the context of full pricing flexibility for basic telephone service, and recommended that issue be considered in a separate phase of R.05-04-005 or in a separate proceeding.[71]

The Commission agrees with this viewpoint and intends for this proceeding, as it is generally available to resolve matters associated with the B-Fund, to constitute such a separate proceeding. Parties are on notice that the scope of this proceeding may be amended based on a determination of R.05-04-005 that a particular policy issue would be best resolved in this proceeding. Notice of a revision of scope, if any, will be provided via a ruling to the service list established in this proceeding.

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[70] R.05-04-005, Ordering Paragraph 1.

[71] We do not prejudge the resolution of matters in the R.05-04-005.

IV. Preliminary Scoping Memo

The Commission recognized that competition and technology would evolve over time and determined that a review of the B-Fund should occur on a regular basis.[72] In D.96-10-066, the Commission determined that an initial review of the fund should take place in 1999 and every three years thereafter. This would allow sufficient time to determine whether new entrants are willing to serve high cost areas of the state with the subsidies provided, and to adjust the B-Fund for technological advancements.

In this proceeding, the Commission seeks comments as well as updated information to comprehensively reassess the B-Fund program. It has been nearly ten years since D.96-10-066 was issued, and the reviews every three years have not occurred. There have been dramatic changes to the telecommunications landscape as evidenced in the URF proceeding. Ten years ago, competition for local residential service was in its infancy. Today, ILECs compete with wireless, cable TV providers, and Voice over Internet Protocol providers in both the local and long distance communications markets. Although there is competition for long distance services, "long distance" is disappearing as a stand-alone service as more and more consumers opt for bundled service packages[73] or use internet protocol-based networks.[74] Consumers are in fact increasingly communicating in

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[72] D.96-10-066.

[73] Local Exchange Carriers offer both local and long distance calling in one package, and compete against wireless providers that offer "bucket plans" of minutes in interstate calling areas.

[74] Voice over Internet Protocol service is national or international in scope. *Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, WC Docket No. 03-211, Memorandum Opinion and Order, 19 FCC Rcd 22404 (2004).

ways that bypass traditional telephone networks entirely. For example, it is now common to exchange voice, e-mail, and text messages through wireless phones, personal computers, and other means without ever having to use the public switched telephone network. These changes to the telecommunications landscape, coupled with the fact that we have not conducted a periodic review of the B-Fund program as required by D.96-10-066 [75] nor have we have we met the mandate of SB 1276 to conduct a review of the program by January 1, 2006, requires the Commission to now conduct a fully comprehensive examination into the B-Fund program. We intend our review to be forward looking in scope, and to focus on ways to make our program more competitively neutral, sufficient and predictable, and of the quality of service expected by law.

In this OIR, as a basis to meet these objectives, we request comment and proposals regarding the following issues:

A. Updating Program Costs

In D.96-10-066, we adopted a Cost Proxy Model (Model) to determine the cost of providing telephone service in each Census Block Group (CBG) in California's fifty eight (58) counties. Based on this Model, we defined high cost Census Block Groups as those areas where the cost of providing telephone services exceeded the statewide average cost of $20.30 per access line.

Inputs to the Cost Proxy Model were based on 1994 cost data and utilized 1990 census information. Since that time, demographics in this state have changed significantly. As foreseen in that decision, technological innovations in the telecommunications industry have driven down the incremental costs per

[75] D.96-10-066, Appendix B, Rule 6.C.4.

access line served (costs).[76] An example of this can be seen today in how telecommunications providers are moving to Internet Protocol (IP) platforms, significantly reducing their costs of providing basic telephone service. Therefore, the Commission tentatively concludes that cost assumptions underlying the B-Fund subsidy levels need to be updated for current conditions.

The Model is not supported and is no longer available for use due to the purchase of the last proponent of the Model by another company. However, even if the model was available, it would be difficult to update as we continue to move further away from cost-of-service regulation. Given these circumstances, we believe it is not practical to revisit the updating of the Model.

While we elect not to update the inputs to the Model, we tentatively conclude that we should still update the estimated total cost of providing basic telephone service to Californians in each CBG or similar discernable area for current conditions. Such a reevaluation is long overdue given the changes in technology in the past decade. We also tentatively conclude that we should investigate ways of more accurately estimating the level of subsidy needed, if any, to promote the goal of universal service. The methodology developed to assess both estimated costs of basic service and subsidy levels needs to be simple, repeatable in the future, and must, at the same time, account for advances in technology. The resulting process should be capable of accommodating modifications and/or policy changes from both the FCC and the California State Legislature which impact this program. In this proceeding, we will consider the

[76] *Ibid.* at Appendix A *citing* D.95-07-050 Proposed Rule 6.A.7.

following alternatives for updating the estimated cost of basic service for purposes of the B-Fund:

1. Modify High Cost Areas Based on Population Density

In general, the higher the population density, the lower is the incremental cost of providing telephone service. Much of the current and likely future population growth has been in areas near cities. As a result, because population growth in high cost areas are likely to drive down the costs of provisioning service, it is highly probable that certain areas that were designated as "High Cost" areas in 1996 no longer belong in that category now. See Appendix A, Table 1 for a list of 28 California counties that have experienced population growth exceeding 15% from 1990 to 2000.

Currently, a fixed per line subsidy amount is paid to carriers for each primary residential access line in eligible "high cost" areas. Therefore, population growth in these areas permits carriers to make larger and larger subsidy claims for areas where costs may actually be declining. This trend will continue as more and more population growth occurs in low density "high cost" suburban and rural areas. Thus, while carriers' real costs may be declining, their claims on the Fund may actually be increasing, resulting in an inappropriate large share of fund recipient cost recovery being borne by the fund.

We solicit comment on whether it is reasonable to revise our list of High Cost areas based on the most currently available census data concerning population density and if so, what revisions in the listing of designated High Cost areas would result. Parties may also offer any alternative criteria that they believe should be considered in updating the list of designated High Cost areas.

2. Use De-averaged Costs and Commission-Adopted UNE-P Based Costs for SBC and Verizon

Competitive Local Exchange Carriers may offer services to their customers using Unbundled Network Elements (UNE) purchased from the ILEC networks. By purchasing UNEs, competitors are able to use portions of these incumbents' networks to offer competitive local exchange services. The primary UNE is the copper twisted wire pair or "loop" that provides the "last mile" connection to a customer's premise. When a Competitive Local Exchange Carrier purchases an incumbent's UNE loop plus its switching services, it is termed a "UNE platform" or UNE-P.[77] The UNE costs are an outcome of the Commission's Open Access and Network Architecture Development (OANAD) proceeding.[78]

In D.04-09-063 and D.05-03-037, the Commission adopted UNE rates for Pacific Bell / SBC service territories. In D.06-03-025, the Commission adopted UNE rates for Verizon's service territory.[79] These Decisions de-average the UNE related costs in each of these ILEC service territories. See Appendix A, Table 2 for Commission-adopted UNE loop costs.

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[77] UNE-P refers to the combination of a 2-wire loop, 2 wire-port, tandem switching and transport and is calculated assuming 1,400 local minutes and 300 toll minutes of usage. Based on recent federal actions, local exchange carriers are no longer required to sell UNE-P to competitors. [*In the Matter of Review of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (WC Docket No. 04-313, CC Docket No. 01-338); Order on Remand, FCC No. 04-290, (rel. Feb. 4, 2005) ("TRRO")] Nevertheless, UNE-P rates may provide a reasonable basis upon which to establish current estimates of B-Fund statewide average and CBG-specific costs.

[78] OANAD Proceeding. R.93-04-003.

[79] OANAD Proceeding. R.93-04-003.

The UNE loop costs adopted by the Commission can be overlaid on the CBGs based on the 2000 census. This proposal will result in de-averaging costs over zones that have been adopted by the Commission. The advantage of this approach is that it will result in forward-looking costs being used for CBGs. The disadvantage is that the de-averaged zones are much larger than that currently being used by CBGs. As a result, certain high cost fund areas within each zone will not be captured while other, low cost areas will be included as high cost fund areas.

We intend to explore the extent to which UNE costs may provide a reasonable basis upon which to establish current estimates of B-Fund statewide average and CBG-specific costs. Such a methodology would also take into account the impact of telecommunications technology advancements in High Cost Fund areas. We recognize that our consideration of using adopted UNE costs will only be useful in AT&T's and Verizon's service territories. We also recognize that UNE rates reflect the wholesale cost of discrete network elements while the B-Fund proxy has used the estimated costs of providing basic retail service as a surrogate for meeting the statutory requirement of affordable basic retail service. We thus seek comments on whether, or to what extent, using UNE-loop costs for computing CBG specific costs of basic retail service is a reasonable way to proceed in updating the B-Fund, or whether other proxies should be used.

3. Modify CBG Costs for Frontier Communications and SureWest

Frontier Communications and SureWest do not have Commission-authorized UNE costs established for their respective service territories. However, as discussed later, in D.05-08-004 we have required SureWest to develop and submit a cost proxy model using its current costs and to report on its impact on several funds including the B-Fund.[80] Accordingly, as part of its comments in this OIR, SureWest shall provide the status of the development, results, and submission of its cost proxy model. We also seek parties' comments on the methodologies to be considered for B-Fund costs of basic service and subsidies in the service territories of Frontier Communications, incorporating, as appropriate, updated CBG population data as discussed above.

B. Evaluate Whether Universal Service Rate Support Levels Can Be Reduced While Still Meeting the Goals of This Program

One of the goals of the B-Fund program is to maintain a fair and equitable local rate structure for access to universal service in high cost fund areas for all Californians. In the current telecommunications landscape, we need to determine if the program is competitively and technologically neutral and whether the rate structure is "fair and equitable." Pursuant to statute, we must evaluate whether, or to what extent, universal service rate support levels can be reduced while still meeting the goals of this program.

B-Fund carrier subsidies have shown significant swings from one year to the next. For example, at Fund inception in February 1997, the B-Fund was designated to provide $352 million per year in carrier subsidies. By 2001, the subsidy had grown to $439 million. By 2004, the subsidy amount was at $401.4 million. Details are given in Appendix A, Table 3. Similarly, the contribution rate has also fluctuated greatly over time.[81]

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[80] D.05-08-004, Ordering Paragraph 2.

[81] The B-Fund is funded by an all-end-user surcharge that is billed and collected by telecommunications carriers from their customers. The surcharge rate is based on the

Footnote continued on next page

Contrary to the expectation when the B-Fund was created, costs have not gone down. Costs have actually shown significant swings while generally trending higher. We believe that we should investigate why costs are not going down as technology advances and to consider appropriate actions to control the size of the B-Fund while maintaining program goals.

B-Fund subsidies work to lower the cost of local service to consumers by allowing carriers to either maintain lower than cost local rates or pass the subsidy through to customers through a surcredit. As such, the Public Utilities Code does not permit a recipient to cross-subsidize other services.[82] However, competitive carriers in the Uniform Regulatory Framework proceeding argue that such potential exists.[83] Those parties also argue that the B-Fund has not encouraged competition for local residential subscribers in high cost areas. [84] We ask parties if they agree or disagree with these arguments and submit supporting documentation to demonstrate their positions.

We seek comments on whether we should continue or eliminate the B-Fund. If we should continue the B-Fund in its present form, then what is the

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level of B-Fund claims and reserve levels maintained by the program. At program inception in 1997 the surcharge was set at 2.7%. That rate was increased to 3.8% in 1999, was gradually reduced to 1.42% in July 2002. That rate grew steadily to 2.7% in July 2003, went down to 2.2% in January 2004, increased to 2.43% in January 2005 and is set at 2.00% for 2006. CPUC Resolution T-16964, adopted December 1, 2005. *See* Appendix A, Table 4 for a history of B-Fund surcharge rates.

82 PU Code Section 728.

83 R05-04-005; Opening Briefs of Cox California Telecom, LLC, p.19 and of, California Cable & Telecommunications Association (CCTA), pp. 8-10; Reply Brief of Cox California Telecom, LLC, pp. 6-7; Transcript at 833 (Cox); Transcript at 836-837 (CCTA).

84 R05-04-005; .Opening Brief of Cox California Telecom, LLC, p18; Reply Brief of Cox California Telecom, LLC, pp. 6-7.

rationale for this action and should we consider reducing its size? Alternatively, if parties believe that we should discontinue and/or alter provisions governing the B-Fund, comments should address how such discontinuance or alteration would affect the goals of universal service. We seek comments on the following options to modify the B-Fund program: (1) Modify the B-Fund threshold level; (2) Cap the B-Fund subsidies; or (3) Apply a means test for subsidies in high income areas.

1. Modify the B-Fund Threshold Level

In D.96-10-066, based on inputs to a Model, we defined high cost CBG's as those areas where the cost of providing telephone services exceeded the statewide average cost of $20.30 per line in service territories of the state's four large and mid-sized LECs. The $20.30 per line cost figure acts as a threshold level beyond which carriers may qualify for B-Fund support. Since the adoption of CBG costs in 1996, however, the makeup of the states population demographics, technology and costs of providing service have changed significantly. As a result, the threshold level has become outdated. To the extent that we update the basic service costs as discussed in the preceding section, there will be a corresponding change in the statewide average cost threshold which is currently based on the outdated $20.30 per line figure.

We also seek to examine other ways to revise the threshold level beyond which carriers may qualify for B-Fund support. In particular, we seek comment on whether to set the threshold level above statewide average cost based upon criteria established by the FCC. The FCC modified the federal high-cost support mechanism for non-rural carriers and adopted measures to induce states' to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers.[85] The FCC requires states to certify that rates in rural areas served by non-rural carriers are reasonably comparable to a national urban rate benchmark of two standard deviations above the average urban rate or about 140% of the average urban nationwide rate of $24.31 per line.[86] That threshold rate level, within two standard deviations ($34.21) from the average urban rate, is considered a "safe harbor" rate. Rates less than the threshold would be presumed reasonably comparable, and states could certify that basic service rates are reasonably comparable without submitting rate information. A state would have the option of submitting rate information to show that factors

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[85] FCC 03-249, issued October 16, 2003, *remanded, Qwest Corp. v. FCC*, 398 F.3d 1222 (10th Cir. 2005).

[86] Federal Communications Commission Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, May 25, 2005. Non-rural carriers may receive high-cost support based on forward-looking costs, as estimated by an FCC cost model. For each state, the cost model calculates the wire center forward-looking cost per line incurred by non-rural carriers to provide supported services. The statewide average cost per line is then compared to the national average cost per line to determine eligibility for support. The forward-looking support mechanism provides support to non-rural carriers in those states that have a statewide average forward-looking cost per line greater than the national benchmark, which was set at about 140 percent of the national average forward-looking cost per line. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999)(*Ninth Report and Order*), *remanded*, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2003)(*Qwest I*), *Order on Remand*, 18 FCC Rcd 22559 (2003), *remanded*, *Qwest II*, 398 F.3d 1222.)(the current benchmark is set at two-standard deviations above the national average cost, which is currently about 140 percent of the national average forward-looking cost per line).

other than basic service rates affect the comparability of its rates in high-cost areas.[87]

A review of claims filed by the largest four B-Fund eligible COLR indicates that increasing the threshold of high cost fund from the current $20.30 to the FCC adopted "safe harbor" benchmark of $34.21 per subsidized line would reduce their B-Fund draw by approximately $30 million each month.

We seek parties' comments on whether the Commission should increase the current High Cost Fund subsidy threshold level from the current $20.30 per line benchmark to the FCC adopted "safe harbor" benchmark of $34.21 per line. Parties should provide supporting rationale for their position, focusing on how the goals of universal service would be impacted and what other relevant impacts should be considered. We anticipate that this benchmark would be changed to mirror any changes adopted by the FCC.

We seek parties' comments on whether the Commission should adopt its own subsidy threshold level separate from the FCC benchmark. Parties should provide supporting rationale for their position, focusing on how the goals of universal service would be impacted, what other relevant impacts should be considered, and how the benchmark would be updated over time.

We also seek input on whether we should require each incumbent local carrier to provide confidential data to assist the Commission in calculating a benchmark, or for other reasons related to calculating high cost support. To the

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[87] For example, if its rural rates exceeded the benchmark, a state would be permitted to explain in its certification why its rural rates were reasonably comparable. Similarly, a state could explain in its certification that its rural rates were not reasonably comparable to nationwide urban rates, despite being within the safe harbor created by the nationwide urban rate benchmark.

extent that any such data is deemed necessary, parties should present proposals concerning the use of nondisclosure agreements and other appropriate protocols to safeguard the confidentiality of such data consistent with adequate due process in developing the record.

2. Cap B-Fund Subsidies

A primary goal of universal service is to increase the penetration of basic telephone service in the state. Another important goal is to maintain "competitive neutrality" in offering of telecommunications services. When the original Cost Proxy Model was adopted in D.96-10-066, alternate cost effective technologies like wireless and satellite telephones were not readily available in certain low density high cost areas. As a result, the subsidy amounts for lines in some high cost areas were quite high. See Appendix A, Table 5 for a list of counties where CBG costs exceed $85.00. In view of changes in the competitive landscape and advances in technology in recent years, we seek to examine the prospects for relying on competitive market forces to increase the penetration of basic telephone service into high cost areas. In this context, we intend to explore the prospect for capping the B-Fund subsidy amount, as explained below.

A review of claims filed by the largest four B-Fund eligible Carriers of Last Resort indicates that less than 1% of claims are for subsidies that exceed $85.00 per line. From a public policy perspective, the continuation of paying excessively high subsidies appears to be an inefficient burden on other ratepayers. Therefore, given it represents less than 1% of claims, we solicit comments on capping the maximum subsidy amount that should be given for B-Fund lines at $85.00 per line. We request information on impacts such a policy may have on users in excessively high cost areas (usually very remote or insular areas). We also seek comments on whether, or to what extent, the availability of

Voice over Internet Protocol services offered by cable carriers or other communication services provide competitive constraints that limit the need for B-Fund subsidies in many regions.

We seek comments particularly from cable, wireless, and satellite companies to ascertain if a cap of $85.00 is a meaningful incentive for provisioning of basic services using alternative technologies especially in sparsely populated rural high cost areas of the state. In the alternative, parties may propose alternative caps or limitations on subsidies available through the B-Fund. Whatever position parties take with respect to subsidy caps, they should provide supporting rationale and documentation, as relevant. We also seek comments from all parties on how we can reduce any barriers to entry and promote incentives to get wireless providers or other non-traditional carriers to offer basic residential telephone services in sparsely populated high cost areas. We also seek comment on whether or through what means the Commission should actively encourage deployment of new technologies as a competitive force to drive down the costs of basic service in very high cost areas.

3. Apply a "Means Test" for Subsidies in High Income Areas

Residents in a number of California counties have per capita incomes that far exceed the statewide median per capita income. See Appendix A, Table 6 for a list of counties with per capita incomes exceeding the median per capita income for all Californians. While most residents of such counties can afford to pay for basic residential telecommunications services without a subsidy, some residents cannot afford those services without a subsidy. Therefore, we will consider applying a "means test" filter to residents of High Cost Fund area CBGs to exclude B-Fund support to individuals with the highest per capita income. By applying such a filter, ULTS and other qualifying customers would continue to receive the same subsidies as they do now based on the CBG cost. Carriers would not be impacted since they will continue to be subsidized for their high cost of providing service by customers through higher rates.

We seek comment on impacts to universal service goals should we exclude high cost support to high income consumers. We seek comments on whether to apply a "means test" filter for high cost subsidies to residents of high cost fund areas whose household income exceeds a specified limit, and if so, what limits on income level would be reasonable. In particular, we seek comments as to whether 115% of the statewide per capita income would serve as a reasonable limit. We seek comments on how such a filter could be applied given how the support is generated for the carrier's network and is not currently specific to any particular household. We are also interested in comments on alternative methodologies that can be efficiently applied to accomplish the goal of limiting subsidies to such households.

C. Should "Extended Area Service" Payments from the B-Fund to SureWest Be Discontinued?

In D.00-11-039, the Commission ordered the use of the B-Fund to make annual payments of $11.5 million to SureWest until further ordered by the Commission.[88] Those payments were originally made by Pacific Bell to offset SureWest's intrastate regulated operating expenses but were replaced by payments from the B-Fund on an interim basis during pendency of an OII to determine a permanent replacement mechanism for Extended Area Service

[88] D.00-11-039, Ordering Paragraph 2.

revenues that it had received from Pacific Bell. In D.05-08-004, we authorized SureWest to continue receiving these interim payments from the B-Fund and required SureWest to develop and submit a Model utilizing its current costs and to report on the impact of the same on: a) its rates; b) the Universal Lifeline Telephone Service fund; and c) the B-Fund within 12 months of adoption of D.00-11-039. We also authorized SureWest to file an application to request authority to modify the Model in its service territory for the B-Fund at the time of its filing. We invite parties to comment on discontinuance of the Extended Area Service payments to SureWest from the B-Fund. We also invite parties to comment concerning the advisability and impacts of phasing out the EAS payments gradually over a period of approximately 5 years, versus immediate elimination.

D. Revenue Neutrality and Utility Reimbursement

Under rate of return regulation appropriate to a local service monopoly provider, the Commission traditionally applied the principle of "revenue neutrality" to ensure that regulatory changes imposed on carriers did not adversely affect carriers' financial viability or result in an unwarranted windfall. For example, when the Commission established the B-Fund, it determined that "in order to make subsidies for high cost areas explicit, there must be a correlating downward adjustment of rates or price caps through a surcredit or reduction in tariffed rates or price caps so as to prevent the ILECs from recovering implicit subsidy support as well."[89] The Commission required a reduction in rates for certain SBC services (except residential basic service) for

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[89] D.96-10-066 at 207.

the company to remain revenue neutral.[90] Since then, as the Commission relies more on competitive markets to set prices, the requirement of revenue neutrality makes little sense in a competitive environment. For example, the NRF ILECs have considerable pricing flexibility for their competitive services. Currently when NRF ILECs increase or lower prices for competitive services, there is no attempt to achieve revenue neutrality. Therefore, we intend to examine whether the concept of revenue neutrality has become incompatible with the competitive market that exists in modern telecommunications.

In the case of the B-Fund, the issue of revenue neutrality is further complicated by the fact that both incumbent and competitive carriers receive subsidies. The Commission has never applied the concept of revenue neutrality to competitive carriers.

D.96-10-066 anticipated that the need for subsidies may diminish over time due to competition and technological advancement.[91] The Commission also anticipated that a Carrier of Last Resort (COLR) may want to withdraw as the only COLR in a particular high cost area. To address these concerns, the Commission proposed an auction mechanism that eliminates the need for contentious cost studies. The auction approach also appears to resolve concerns over revenue neutrality.

Under the current rules, a designated COLR may opt out of its obligations in a high cost area by advice letter, unless it is the only carrier remaining in the area, in which case it must file an application to withdraw as the COLR, and

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[90] D.98-07-033 implemented the rate reductions to offset explicit subsidy support provided by the B-Fund.

[91] D.96-10-066 at 215.

continue to act as the COLR until the application is granted or a new COLR has been designated as a result of an auction.[92] Therefore, should the Commission determine that subsidies should be reduced, capped or be otherwise limited, an existing COLR may seek to withdraw from a high cost area. Thus, the Commission is not required to make subsidy adjustments revenue neutral for an existing COLR, and the COLR would not be required to continue providing service at the reduced subsidy level. The Commission would then hold an auction and designate a new COLR with the lowest bid to serve the area. That winning bidder could very well be the existing COLR willing to provide service at the reduced subsidy level (depending on its bid).

The Commission ordered workshops to assist in developing an auction mechanism for serving high cost areas.[93] Workshops were held on May 8 and

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[92] The rules are as follows: If there is only one carrier in a high cost area and that carrier has filed an application to withdraw as the Carrier of Last Resort (COLR) in that area, and no other provider is willing to assume the COLR responsibility at the current subsidy level, the Commission will initiate an auction whereby service providers shall bid on the amount of subsidy each would require to operate as the COLR. Such auction will be held within 180 days from the time the application to withdraw as the COLR is filed. The qualified bidder who places a bid representing the lowest amount of subsidy required to offer service in the GSA would become the subsidized COLR for a period of three years. Competitive entry would be allowed, but only 1/2 the subsidy would be available to the competitor. A COLR who loses the bid shall have the option to sell its facilities in the area to any interested party. One-hundred(180) days prior to the expiration of the three-year COLR obligation, all carriers desiring to become a designated COLR in the GSA shall file applications stating their intention to become the designated COLR for that particular service area. The Commission will then determine whether the same designated COLR should be retained at the current subsidy, whether multiple carriers of last resort should be permitted and at what subsidy amount, or if another auction should be held. D.96-10-066, Appendix B, Rule 6.D.7.

[93] OP 16(d) of D.96-10-066 as modified by D.97-01-020 (in R.95-01-020/021) regarding Universal Service.

May 9, 1997. Telecommunications Division issued a workshop report on November 7, 1997.[94] However, the auction mechanism explored in those workshops was never put in place and further proceedings would be required before an auction could be implemented. We discuss the prospects for an auction mechanism to deal with not only the designation of a new Carrier of Last Resort, but also for establishing support levels for existing Carriers of Last Resort *supra*.

Should there be a revenue shortfall for those telecommunications utilities that currently receive B-Fund program subsidies, we request comment on whether, and if so, how to address any such revenue loss. Assuming that the concept of revenue neutrality was found to be incompatible with the modern telecommunications market, we seek comment on whether there would be any basis justifying reimbursement through the B-Fund for shortfalls. On the other hand, if prices are permitted to move closer to cost, there would be a diminished need for the B-Fund support. We thus seek comments from parties as to whether we should continue to reimburse carriers for their expected shortfalls as a result of pending changes to the B-Fund program particularly as we examine whether

[94] In the conclusion section of the Workshop Report, Telecommunications Division (TD) recommended that the Commission pursue the development of an auction mechanism on three separate tracks. First, the Commission should investigate the outstanding legal issues surrounding competitive bidding: (1) Can the Commission restrict support to only winning bidders or does this constitute an additional condition on eligible carriers which violates the Telecommunications Act? (2) Can the Commission relieve a COLR of its interconnection obligations? And (3) Can the Commission require an exiting ILEC COLR to sell its facilities according to a specified pricing formula? While the first issue is critical as to whether or not an auction mechanism can work, the second and third issue may or may not be critical, but would shape the way a competitive bidding system is structured.

the concept of revenue neutrality continues to have any relevance in today's market environment. Parties should likewise address what other alternatives, if any, we should be considering as a means of meeting the goal of universal service besides providing explicit reimbursement to carriers for claimed shortfalls in serving such High Cost areas.

E. Auction Universal Service Support by Disaggregated Area

As discussed *infra* the Commission previously considered the use of auctions in the universal service context in D.96-10-066, where it examined using auctions in the context of designating a new carrier of last resort where the incumbent carrier of last resort had filed to withdraw from that status. Auctions could also be used to determine support levels for all carriers of last resort.[95] In an auction process the true economic cost for providing service to the designated area would be established through the bidding process, while at the same time providing affordable service to customers.

Under such a process, carriers would bid for the lowest amount needed from the fund in order to become the primary carrier for the specified area. An area could constitute an entire serving area or some smaller subdivision thereof. Universal service support would be allocated for the network of the lowest bidder in a particular geographic region rather than multiple operators in one region. In exchange for receiving universal service support for a period, a carrier

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[95] The idea of using an auction mechanism to allocate universal service support has also been raised recently at the federal level. FCC Chairman Kevin Martin discussed the "reverse auction" concept at the Bank of America Media and Telecommunications Conference in New York City on March 29, 2006. Computerwire (March 30, 2006), http://www.computerwire.com/industries/research/?pid=5CC92278%2D7D1A%2D4C3F%2DB6B2%2D76BB295E091D [last checked May 31, 2006].

would be designated the carrier of last resort. Some auction proposals limit support to one carrier of last resort, while others permit more than one carrier to receive the same or less support (second lowest bid or some ratio of the lowest bid). We seek comment on the merits of adopting such a system and input on the entire process for delivering universal service support through such a mechanism. Most proposals for using such an auction process would hold the auction every five years. Is this timeframe too short, too long, or just right? What level of disaggregating should be used in such an auction mechanism? How many carriers should be eligible in a given area and how should support be allocated if more than one carrier is eligible? We solicit auction proposals that comprehensively address the delivery of universal service support.

F. Program Administration Implementation Issues

In this rulemaking, we also seek to examine ways to make the B-Fund Program administration more efficient and streamlined. The Commission's Telecommunications Division has automated parts of the claims validation process. However, the claims review process continues to be labor intensive. Carriers of Last Resort submit claims in a specified format and Telecommunications Division staff verifies the appropriateness of filed claims. Validation of claims is done by comparison of claims with backup information and through periodic audits. We believe that further automation for claims processing will be cost effective in the long run and save program administration costs.

We request comments on whether the Telecommunications Division should investigate setting up of an automated claims review program. Such a program would require claimants to file claims electronically. A program can then be developed that will automate some of the repetitious tasks that are currently performed by TD staff. This will not obviate the need for verification of claims against actual Carrier of Last Resort records but, this will reduce the total time taken for review of claims.

V. Solicitation of Comments

Based upon the relevant scope of inquiry as set forth above, we solicit comments on the following issues:[96]

A. Updating Program Costs

1. Should the Cost Proxy Model adopted in D.96-10-066 be updated? If so how? If not, what alternative sources of relevant data provide an efficient and expedient vehicle for developing updated costs of basic service as required for assessing the level of B-Fund requirements?
2. Should the existing high cost areas be modified using the updated Census Block Group (CBG) population data from the 2000 Census?
3. Should CBG costs be updated using Commission-adopted UNE-P based loop costs for AT&T and Verizon? If so, what are the pros and cons? Explain and justify whether, or to what extent, UNE cost data can serve as a relevant proxy for the basic retail costs of service required for assessing the appropriate level of B-Fund requirements.
4. What data sources should the Commission consider for computing the CBG costs for Frontier Communications?
5. Should the Commission reconsider use of a Cost Proxy Model for SureWest as ordered in D.05-08-004?

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[96] To the extent questions identified for comment in the preceding text are not explicitly set forth below, parties are still expected to address those questions in their filed comments.

SureWest shall provide updated status on compliance with D.05-08-004 regarding the submission of a Cost Proxy Model relevant to the assessment of B-Fund requirements.

6. Should the Commission consider the total cost or the long range incremental cost when determining the cost of provisioning basic residential telephone service for use in assessing B-Fund requirements? Explain why or why not.

7. Are there other models (e.g. revenue based models as mentioned in the FCC's NPRM or those models used by other states) that the Commission should consider? How should these models be designed?

8. To what extent should the Commission utilize cost of service data (including potentially confidential data) provided by each of the NRF ILECs as a means of updating relevant costs for assessing B-Fund requirements? Provide supporting rationale.

B. Modifying the Size of the B-Fund

1. Should the Commission continue, reduce or eliminate the B-Fund program? Why or why not? Provide supporting rationale consistent with the Commission's universal service goals set forth in SB 1276.

2. If the Commission considers reducing the size of the B-Fund program, then:

   (a) Should the high cost threshold level be increased from the current statewide average cost of $20.30 to some level above statewide average cost? If so, what would be a reasonable threshold level, based on what criteria? In particular, is it reasonable to set the threshold at the FCC "safe harbor" benchmark of $34.21 per line? Why or why not?

   (b) Should the Commission cap B-Fund subsidies to $85.00 per line based on the fact that less than 1% of subsidy claims exceed that amount? If not, would another cap be reasonable? Explain why or why not consistent with the Commission's universal service goals set forth in SB 1276.

3. If a cost proxy is continued to be used as a surrogate standard for affordable rates, should this cost proxy be different for different geographic areas of the state? If so, explain how such affordability levels should be measured and geographically differentiated. What level of support is "reasonable?"
4. Should the Commission require a "means test" for computing subsidies to residential customers who are in high income brackets? If so, how?
5. If a "means test" is used for limiting B-Fund subsidies from the highest income residential customers, should any adjustment to carrier subsidies occur? Explain why or why not consistent with the Commission's universal service goals set forth in SB 1276.
6. What other alternative methodologies can be efficiently applied to accomplish the goal of limiting subsidies to households?

C. Discontinue Extended Area Service Payments for Non-B-Fund Program Events

1. Should the Commission consider discontinuing Extended Area Service payments to SureWest, from the B-Fund, as ordered in D.00-11-039? Why or why not? If so, what alternatives should be considered to meet the Commission's universal service goals?

D. Revenue Neutrality and Utility Reimbursement

1. Is the Commission obligated to apply the principle of "revenue neutrality" if and when it makes changes to B-Fund subsidy levels? If so, why, and if not, why not?
2. If the Commission allows carriers the freedom to price basic residential services, would revenue neutrality need to continue? If so, why or why not?

3. If the Commission determines that revenue neutrality is appropriate to B-Fund changes, should revenue neutrality apply equally to incumbent and competitive carriers participating in the B-Fund?
4. If the Commission determines that revenue neutrality is appropriate to B-Fund changes, how should it account for revenue differences related to rates that have changed for competitive reasons since they were adjusted when the B-Fund was established?

E. Auction Mechanism

1. What are the relevant issues involved in adopting an auction mechanism to deal with the designation of a new COLR as well as for establishing support levels for exiting carriers? How should an auction be designed and how frequently should such an auction be held?
2. What level of disaggregating should be used in such an auction mechanism? How many carriers should be eligible in a given area and how should support be allocated if more than one carrier is eligible? Comments are also solicited regarding the issues raised in the Telecommunications Division Workshop Report on an auction mechanism, as referenced in footnote 94 above.

F. Program Implementation Issues

1. How can the B-Fund program implementation be made more efficient?
2. Discuss reporting requirements or any other issues associated with an automated claims review program.

G. General Issues

1. Is the B-Fund program meeting its goal of promoting universal service?
2. Is the B-Fund program achieving its goal of reducing rate disparity in residential basic rates between rural and urban areas while at the same time encouraging competition?

3. Are current Commission policies conducive to driving down B-Fund costs in high cost areas by encouraging the deployment of alternative new technologies?
4. Is $85.00 per line as a subsidy cap a meaningful incentive for provisioning of alternate technologies like wireless and satellite in high cost fund areas? If not, are there alternative ways to achieve a similar result?
5. What steps should the Commission consider to reduce barriers to entry to encourage wireless providers to offer basic residential services in sparsely populated areas?
6. Should the Commission reconsider the definition of basic residential service and include enhanced services like broadband, etc? If so, should the ILECs be required to provide confidential data on their respective costs in providing such service?
7. Please provide any other proposals to reduce the size of the fund while still meeting the goals of the program in the face of market and regulatory changes.

VI. Category of Proceeding

The Commission's Rules of Practice and Procedure require that an order instituting rulemaking preliminarily determine the category of the proceeding and the need for hearing.[97] As a preliminary matter, we determine that this proceeding is quasi-legislative. As provided in Rule 6(c)(2), any person who objects to the preliminary categorization of this rulemaking as "quasi-legislative" or to the preliminary hearing determination, shall file and serve its objections with its opening comments.

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[97] Rule 6(c)(2).

VII. Schedule

The preliminary schedule is set forth below. We delegate to the Assigned Commissioner and the ALJ the authority to set other dates in the proceeding or modify those below as necessary.

Comments on OIR issues set forth above	August 4, 2006
Reply comments	September 15, 2006

The determination on the need for further procedural measures, including discovery, technical workshops, and/or evidentiary hearings will be made in one or more rulings issued by the Assigned Commissioner. Any party who believes that an evidentiary hearing is required shall file a motion requesting such a hearing no later than ten business days after the filing of reply comments. Any such motion must identify and describe (i) the material issues of fact, (ii) the evidence the party proposes to introduce at the requested hearing, and (iii) the schedule for conducting the hearing. Any right that a party may otherwise have to an evidentiary hearing will be waived if the party does not submit a timely motion requesting an evidentiary hearing.

Following receipt of any such motions, the Assigned Commissioner and ALJ shall determine the need for and extent of further procedural steps that are necessary to develop an adequate record to resolve this rulemaking, and shall issue rulings providing guidance to parties, as warranted.

This proceeding will conform to the statutory case management deadline for quasi-legislative matters set forth in Public Utilities Code §1701.5.

VIII. Parties and Service List

Interested persons will have 15 calendar days from the date of mailing to submit a request to be added to the service list for this proceeding. We will serve this order on all telecommunications carriers, the B-Fund Administrative Committee and parties on the service list of R.95-01-020/I.95-01-021.

Within 15 days of the date of mailing of this order, any person or representative of an entity seeking to become a party to this rulemaking should send a request to the Commission's Process Office, 505 Van Ness Avenue, San Francisco, California, 94102 (or ALJ_Process@cpuc.ca.gov) to be placed on the official service list for appearances in this proceeding. Individuals seeking only to monitor the proceeding, but not to participate as an active party may request to be added to the "Information Only" section of the service list. The service list will be posted on the Commission's website: www.cpuc.ca.gov prior to the time comments are filed pursuant to Ordering Paragraph X.

Any party interested in participating in this rulemaking who is unfamiliar with the Commission's procedures should contact the Commission's Public Advisor in Los Angeles at (213) 649-4782 or in San Francisco at (415) 703-7074, (866) 836-7875 (TTY – toll free) or (415) 703-5282 (TTY), or send an e-mail to public.advisor@cpuc.ca.gov.

The Commission has recently adopted rules for the electronic service of documents related to its proceedings, Commission Rule 2.3.1, available on our website at http://www.cpuc.ca.gov/PUBLISHED/RULES_PRAC_PROC/44887.htm. All parties shall comply with the requirements of the new rule.

IX. Ex Parte Communications

Per Rule 7(d) of the Commission's Rules of Practice and Procedure, *ex parte* communications are allowed without restriction or reporting requirement in any quasi-legislative proceeding. Therefore, there are no such restrictions or reporting requirements applied to this proceeding.

Therefore, **IT IS ORDERED** that:

1. The Commission hereby institutes this rulemaking on its own motion to review the costs associated with the California High Cost Fund-B program.

2. The issues to be considered in this proceeding are set forth in the Preliminary Scoping Memo as proposed changes to the Commission's California High Cost Fund-B program.

3. The Executive Director shall cause this Order Instituting Rulemaking (OIR) to be served on all telecommunications carriers, the B-Fund Administrative Committee and parties on the service list of R.95-01-020/I.95-01-021.

4. Within 15 calendar days from the date of mailing of this order, any person or representative of an entity interested in becoming a party to this rulemaking shall send a request to the Commission's Process Office, 505 Van Ness Avenue, San Francisco, California, 94102 (or ALJ_Process@cpuc.ca.gov) to be placed on the official service list for this proceeding. Individuals interested only in monitoring the proceeding may request to be placed on the "Information Only" section of the service list. This service list will be posted on the Commission's website, www.cpuc.ca.gov, prior to the time comments are served pursuant to Ordering Paragraph 8.

5. All parties shall abide by the Commission's new electronic service rules contained in Rule 2.3.1 of the Commission's Rules of Practice and Procedure.

6. We preliminarily determine the category of this rulemaking to be "quasi-legislative" and preliminarily determine that hearings are unnecessary. Parties objecting to these determinations shall include their objections in their opening comments.

7. Any party who believes that an evidentiary hearing is required shall file a motion requesting such a hearing no later than 10 business days after reply comments are due. Any such motion must identify and describe (i) the material issues of fact, (ii) the evidence the party proposes to introduce at the requested hearing, and (iii) the schedule for conducting the hearing. Any right that a party may otherwise have to an evidentiary hearing will be waived if the party does not submit a timely motion requesting an evidentiary hearing.

8. Respondents shall, and other parties may, file opening comments on the issues identified in this rulemaking by August 4, 2006, and reply comments by September 15, 2006.

9. The Assigned Commissioner and Administrative Law Judge will set the schedule for this proceeding by subsequent rulings, as warranted, to develop the record and to bring this rulemaking to a conclusion.

This order is effective today.

Dated June 29, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners

Appendix A – Tables

Table 1: High Cost Fund Counties with Population growth exceeding 15% from 1990 to 2000

ID	County	Population Change	Percent Change
a	b	c	d
06000	California	4,111,627	13.82%
06069	San Benito	16,537	45.06%
06061	Placer	75,603	43.75%
06039	Madera	35,019	39.75%
06065	Riverside	374,974	32.04%
06025	Imperial	33,058	30.24%
06051	Mono	2,897	29.10%
06031	Kings	27,992	27.59%
06017	El Dorado	30,304	24.05%
06035	Lassen	6,230	22.57%
06101	Sutter	14,515	22.53%
06029	Kern	118,168	21.74%
06099	Stanislaus	76,475	20.64%
06071	San Bernardino	291,054	20.52%
06043	Mariposa	2,828	19.77%
06019	Fresno	131,917	19.76%
06113	Yolo	27,568	19.54%
06097	Sonoma	70,392	18.13%
06059	Orange	435,733	18.08%
06013	Contra Costa	145,084	18.05%
06047	Merced	32,151	18.02%
06107	Tulare	56,100	17.99%
06067	Sacramento	182,280	17.51%
06077	San Joaquin	82,970	17.26%
06015	Del Norte	4,047	17.25%
06057	Nevada	13,523	17.22%
06005	Amador	5,061	16.85%
06095	Solano	54,121	15.90%
06033	Lake	7,678	15.16%

Table 2: Commission adopted UNE Loop costs for SBC and Verizon

	# of Wire Centers [1]	Loop Cost [2,3]
	a	b
SBC		
Zone 1	188	$ 9.48
Zone 2	180	$ 12.79
Zone 3	246	$ 26.43
Verizon		
Zone 1	166	$ 11.93
Zone 2	57	$ 46.71
Zone 3	50	$ 134.74
Zone 4	2	$ 525.70

Notes

1 D. 04-09-063, Model HM 5.3
2 D. 04-09-063, Appendix A
3 D.06-03-025, Appendix A

Table 3: CHCF-B Claim Payment History

	CHCF-B Claims	*Catchup Surcredit*	*Total Pmt. Including Catchup Surcredit*
	($1,000)	*($1,000)*	*($1,000)*
1997	$ 321,925.87	$ -	$ 323,922.87
1998	$ 373,920.85	$ -	$ 375,918.85
1999	$ 388,427.09	$ -	$ 390,426.09
2000	$ 402,361.42	$ 81,322.00	$ 485,683.42
2001 [1, 2]	$ 439,993.35	$ 409,876.62	$ 849,869.97
2002 [3, 4]	$ 427,032.74	$ -	$ 427,032.74
2003	$ 403,583.66	$ -	$ 405,586.66
2004	$ 401,389.59	$ -	$ 403,393.59

1 Catchup surcredit paid to Frontier Communications in June, July, August 2001 @ $760,000 each month
2 Catchup surcredit paid to Verizon in May, June and July 2001 @ $26,347,333.33 per month.
3 Catchup surcredit paid to SureWest @ $178,538.67 during March, April and May 2002
4 Catchup surcredit paid to Pacific Bell @ $146,447,000.00 during February, March and April 2002

Table 4: CHCF-B Surcharge Rate History

Effective Date	*Surcharge Rate*
2/1/1997	2.87%
1/1/1999	3.80%
1/1/2000	2.60%
11/1/2001	1.47%
7/1/2002	1.42%
3/1/2003	2.20%
7/1/2003	2.70%
1/1/2004	2.20%
1/1/2005	2.43%
1/1/2006	2.00%

Table 5: HCF counties where Max. cost/line exceeds $85.00

ID	County	CBG Cost/Line		# of CBGs
		Min	Max	
a	b	c	D	e
06000	***California***	***$ 20.31***	***$ 226.12***	
06051	Mono	$ 20.79	$ 226.12	17
06003	Alpine	$ 22.69	$ 204.02	4
06069	San Benito	$ 20.91	$ 155.21	12
06105	Trinity	$ 29.24	$ 140.91	19
06071	San Bernardino	$ 20.33	$ 123.69	505
06035	Lassen	$ 20.73	$ 119.85	20
06079	San Luis Obispo	$ 20.31	$ 109.38	61
06037	Los Angeles	$ 20.32	$ 108.10	1,280
06007	Butte	$ 20.69	$ 101.51	84
06031	Kings	$ 20.58	$ 100.80	45
06023	Humboldt	$ 20.72	$ 98.03	57
06049	Modoc	$ 28.17	$ 95.28	8
06101	Sutter	$ 20.34	$ 95.01	26
06085	Santa Clara	$ 20.36	$ 94.60	397
06103	Tehama	$ 20.39	$ 93.39	31
06065	Riverside	$ 20.31	$ 89.68	401
06099	Stanislaus	$ 20.57	$ 88.70	172
06089	Shasta	$ 20.42	$ 88.52	82
06039	Madera	$ 20.32	$ 87.69	48
06053	Monterey	$ 20.81	$ 87.48	91
06073	San Diego	$ 20.35	$ 85.25	502

Table 6: High Cost Fund Counties with Per Capita Income Exceeding Median income for California for 2003

ID	County	Per Capita Income	
		2003	% of State Med Income
a	*b*	*c*	*D*
06000	**California**	**48,440**	**100.00%**
06085	Santa Clara	68,167	140.72%
06041	Marin	66,616	137.52%
06081	San Mateo	64,998	134.18%
06013	Contra Costa	64,424	133.00%
06061	Placer	61,474	126.91%
06111	Ventura	57,864	119.45%
06095	Solano	56,545	116.73%
06069	San Benito	56,319	116.27%
06001	Alameda	56,166	115.95%
06059	Orange	55,861	115.32%
06017	El Dorado	54,034	111.55%
06097	Sonoma	52,034	107.42%
06055	Napa	51,912	107.17%
06075	San Francisco	51,302	105.91%
06087	Santa Cruz	50,890	105.06%
06073	San Diego	48,634	100.40%

(END OF APPENDIX A)

Appendix B – High-Cost Programs in Other States:[1]

- 19 states (including California) that maintain a functioning high-cost fund.[2]
- 14 states (including California) operate programs similar to the B-Fund (i.e. large ILECs are allowed to participate).[3] These states utilize a variety of models and methods to determine eligibility and carrier reimbursement.

Determining Eligibility for State High-Cost Programs:

- Five states use either the FCC's Hybrid Cost Proxy Model or the HAI Cost Proxy Model (which relies on data from Census Block Groups) (CO, KS, OR, TX , UT, WA);
- Two states utilize a cost model developed by the RBOC (CA, WY), California's program also relies on data from Census Block Groups;
- Four states utilize an embedded cost standard (AK, ID, NV, SC)
- One state only considers USF funding in ratemaking cases (AZ);
- One state applies credit based on the difference between the carrier's authorized rate of return and its actual revenue (NV); and
- One state utilizes county median household income (WI).

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[1] All information in this appendix was compiled through the following sources: Personal communication with state regulatory commissions in February 2006; information from the National Regulatory Research Institute: Rosenberg, et al. *State Universal Funding Mechanisms: Results of the NRRI's 2001-2002 Survey*. Columbus, Ohio: National Regulatory Research Institute [2002]; Ed Rosenberg and Jing Liu. *State Universal Funding Mechanisms: Results of the NRRI's 2005-2006 Survey*. Columbus, Ohio: National Regulatory Research Institute [Draft: April 2006].

[2] AK, AR, AZ, CA, CO, ID, IL, KS, ME, NE, NV, OR, PA, SC, TX, UT, WA, WI, and WY. In addition, three states have approved, but not functioning, High Cost Fund (Fl, IN, VT). Ed Rosenberg and Jing Liu. *State Universal Funding Mechanisms: Results of the NRRI's 2005-2006 Survey*. Columbus, Ohio: National Regulatory Research Institute [Draft: April 2006]. Additional information was garnered through CPUC interviews with state regulatory commissions during February 2006.

[3] AK, AZ, CA, CO, ID, KS, ME, NE, NV, OR, SC, TX, WI, and WY.

<u>To further differentiate need:</u>

- Three states determine high-cost areas utilizing information from individual wire centers (CO, ID, OR, TX);
  - One state requires carriers who receive USF support to propose matching reductions to regulated rates (CO, ID);
  - In two states funding is determined by a PUC-set benchmark less other support (OR, ME); and
  - In one state funding is determined by a PUC benchmark based on local and some portion of toll and access revenue (TX); and
  - Two states utilize a geographic zone system combined with statewide average cost (KS, WY); and
  - Two states utilize Census Block Groups (CBGs) and reimburse based on average weight determined through the model (CA, CO).

<u>Miscellaneous High-Cost Fund Information:</u>

- Of the High Cost Funds similar to the B-Fund, Colorado, Kansas, and Oregon are reviewing their programs. Colorado's docket examines all aspects of the program (051-431T); Kansas is reviewing competition issues remanded by the State Appeal Court; and Oregon's dockets (UM1017; UM73) focus on smaller carriers.

- New Mexico recently adopted a new rule that requires all intrastate communications providers, including Voice over Internet Protocol providers, to pay into the state's Rural Universal Service Fund.[4] In addition, Kansas, Nebraska, and South Carolina require some VoIP providers to contribute to their state High Cost Funds.

[4] State Rural Universal Service Fund, New Mexico Public Utilities Commission, 17.11.10.1-31 NMAC. ONLINE Available: http://www.nmcpr.state.nm.us/nmac/parts/title17/17.011.0010.htm [28 Mar 2006].

Appendix B – Table: Comparison of High Cost Fund Programs in the U. S.

	Are large ILECs allowed to use fund or do large ILECs currently participate?	What method/model/benchmark does your state use?	Ongoing updates to methodology?	Planned Program Changes?
Alaska	Yes. Rural ILECs, Wireless Carriers, Landline CLECs, Non-Rural, Non-RBOC ILECs, RBOCs, and Others may receive support.	Embedded Cost.	Not Available	None Planned.
Arkansas	Not Available	Not Available	Not Available	None planned.
Arizona	Yes, currently only one carrier, a rural ILEC utilizes the fund. All ETCs Eligible.	Only consider USF in rate-making cases. RBOC uses statewide cost averaging, so rural rates are close to urban rates	Taking comments on docket (RT-00000H-97-0137)	Unsure. Docket is not active.
California	Yes. Carriers of Last Resort (COLR) in high cost areas of CA's four largest ILECs participate in the program.	Utilized Census Block Groups and the RBOCs Cost Proxy Model to determine statewide and per line costs. Reimbursement is made for estimated per line costs over the statewide average.	Not Available	Program is beginning a complete review.
Colorado	Yes. ETCs Eligible.	Utilize the HAI model and Census Block Groups to determine average weight and reimburse for anything over that amount.	Update the ILEC, update the information on a yearly basis	Going through a complete review: program differences between ILECs vs Quest, what is assessed) Open Docket: 05I-431T
Idaho	The large RBOC would be allowed to participate, but has chosen not to.	Wire centers divided into high and low density; low density are eligible for support. Carriers who receive USF must propose matching reductions to regulated rates.	Not Available	None

Illinois	No. RBOC is ineligible; only those with less than 35,000 lines may use.	Only consider number of landlines. HAI model for eligibles.	Illinois experienced challenges differentiating voice versus advanced service costs when carriers applied for capital subsidization. They will open a docket in next six months and will most likely allow capital subsidization (up to 75%) for voice and advanced services. Most rural carriers have already built out, so assume most use will be from municipal projects.	
Kansas	Yes. ETCs Eligible.	Utilize the FCC's Hybrid Cost Proxy Model and made several KS-specific adjustments. Geographical zones. Uses statewide cost averaging to reimburse.	Each company has been audited, will rotate on a 5-6 yr basis. Companies apply through a rate-making case	Until last fall, companies could file on a per line basis; increased lines meant increased fundings. Commission lost litigation, and are now issuing refunds. Originally implemented through telco supported legislation, support waned as lines began decreasing.
Maine	Yes. Rural ILECs, Non-Rural, Non-RBOC ILECs, and RBOCs may receive support.			
Nebraska	Yes Rural ILECs, Wireless Carriers, Landline CLECs, Non-Rural, Non-RBOC ILECs, RBOCs, and Others may receive support.	Cost Proxy Model	Unknown.	No.
Nevada	Yes, but only one recipient currently, a rural ILEC.	Utilize authorized rate of return. After applying federal USF, is still below authorized rate of return, Commission will pay difference.	None	None
Oregon	Yes. Carriers need to meet PUC eligibility standards.	For RBOCs utilized FCC's Hybrid Cost Proxy Model, and calculated cost at wire center level. Funding is based on PUC-set benchmark less federal universal service support and other support.	Currently, trying to update information. Have not updated RBOC information since 2000.	Workshop in 3/06 with small carriers due to increased program costs for those carriers. Dockets: UM1017; UM731
Pennsylvania	"The PAUSF is not a high-cost fund in the normal definition…[it] is more of a mechanism to lower intrastate toll rates and intrastate access charges while keep rural residential rates affordable under and $18 cap.			

South Carolina	Yes. Rural ILECs, Wireless Carriers, Landline CLECs, Non-Rural, Non-RBOC ILECs, and RBOCs, may receive support.			
Texas	Yes, utilize the TX High Cost Universal Service Plan (Similar to CHCF-B). ETCs and ETPs eligible.	For RBOCs utilized HAI and calculated at wire center. Greater cost per lines are subsidized with fund.	Statute bars TX from reassessing wire center.	None
Utah	Yes and No. RBOC is ineligible for ongoing support; anyone (individual or company) can apply for one time support	For one-time support: assess cost to bring service based on engineering study, after determining customer and carrier share, USF pays balance up to $10K/customer	No	None
Washington	No formal high cost program. However, prior to 96 act, they used implicit subsidies on originating and terminating access charges. After the Act, the Commission ruled that all access charges needed to be set at cost. The Commission has accounted for the effects of this change on a case-by-case basis during ratemaking decisions.			
Wisconsin	Allowed to participate. LECs that are ETCs in eligible high rate areas.	Uses county median household income and level of rate. If the rates are between 1.5% and 2% of medium income, the state will reimburse 50% of the rate; between 2% and 2.5%, the state will cover 75% of the rate; and between 2.5-3% of the median county income, the state will cover 95% of the rate.	Wisconsin is mandated to engage in program updates biannually	None at this time.
Wyoming	Yes.	RBOC created geographical zones based on distance from central office, this allows the commission to account for distance and density. RBOC submitted this cost model to Commission, which approved over several years. Funding based on statewide averaging.	Reviewed every 3 years.	None; though there is always possible legislation. NOTE: WY requires providers to show federal and state credit on bill.

(END OF APPENDIX B)